

Longing, Shorting and Spreads

Let's talk definitions.

Longing

To long an asset is to buy it.

To close a long trade (after we bought it), we have to sell what we bought.

Shorting

This is slightly more complicated.

What happens in the background

For stocks and most asset classes, when you sell without owning the asset, it is considered a short.

You get money added to your account (which you can't withdraw) from the short sale. You pay an interest on the short position for as long as you hold it. For some brokers, you can get paid interest on the money you gained from the short sale.

In the background, your broker lends you the stock for you to sell. The broker usually takes it from its other customers. Some brokers pass some of the interests earned from you to the other customers, some don't.

When you close the short position and buy the stock back. The broker takes back the stock and returns it to the other customers whom it borrowed from.

Simple Explanation

To short an asset is to borrow it, then sell it off.

To close a short trade (after we sold it), we have to buy back what we sold.

The aim is to buy it back at a cheaper price. The difference between the (higher) price we sold it at and the (lower) price we bought it back at will be our profit.

If the price you bought it back at is higher than the price you sold it for, you will incur a loss.

In real life, the borrowing part happens in the background. You don't see it. Just click the sell button when you don't have the stock, and the broker will assume you are shorting.

Note that not all stocks can be shorted and not all brokers¹ allow shorting.

Longing and Shorting Spreads

Spreads

A spread is the price difference between one asset and another.

In a pair trade, where we long stock A and short stock B, you can say we are longing a spread between A and B.

¹ https://en.wikipedia.org/wiki/Brokerage_firm

Conversely, if we are shorting a spread of A/B , we are essentially shorting stock A and longing stock B.

Thus, there is a difference between longing/shorting a stock vs longing/shorting a spread. Be careful not to be confused by this.